

## ANALYSIS OF AMENDED BILL

Author: Hurt Analyst: Marion Mann DeJong Bill Number: SB 1425

Related Bills: AB 1631, AB 1633, Telephone: (916) 845-6979 Amended Date: 03/12/98

SB 1478

Attorney: Doug Bramhall

Sponsor: \_\_\_\_\_

**SUBJECT:** Shift Burden of Proof

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended \_\_\_\_\_.

☒ FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.

☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED January 22, 1998, STILL APPLIES.

OTHER - See comments below.

### SUMMARY OF BILL

This bill would add a new provision to the Government Code to shift the burden of proof from taxpayers to the agencies collecting taxes in any court proceeding under certain conditions.

This bill also would declare legislative intent to conform to the Internal Revenue Service Restructuring and Reform Act.

### SUMMARY OF AMENDMENT

The March 12, 1998, amendments moved the burden of proof provisions from the Revenue and Taxation Code (R&TC) to the Government Code and extended the shift in the burden of proof to all state agencies that collect taxes rather than just the Franchise Tax Board (FTB).

The Legislative History, Background, Current Law discussion in Specific Findings, Fiscal Impact and Board Position in the department's analysis of the bill as introduced January 22, 1998, still apply. The remainder of that analysis is replaced with the following.

### DEPARTMENTS THAT MAY BE AFFECTED:

\_\_\_ STATE MANDATE

\_\_\_ GOVERNOR'S APPOINTMENT

#### Board Position:

\_\_\_ S \_\_\_ O  
\_\_\_ SA \_\_\_ OUA  
\_\_\_ N \_\_\_ NP  
\_\_\_ NA \_\_\_ NAR  
☒ PENDING

#### Agency Secretary Position:

\_\_\_ S \_\_\_ O  
\_\_\_ SA \_\_\_ OUA  
\_\_\_ N \_\_\_ NP  
\_\_\_ NA \_\_\_ NAR  
DEFER TO \_\_\_\_\_

#### GOVERNOR'S OFFICE USE

Position Approved \_\_\_  
Position Disapproved \_\_\_  
Position Noted \_\_\_

Department/Legislative Director Date  
**G. Alan Hunter** **3/23/98**

Agency Secretary Date

By: Date:

#### EFFECTIVE DATE

This bill would become operative on January 1, 1999, and would apply to legal actions that are filed in connection with tax disputes that arise on or after that date.

#### SPECIFIC FINDINGS

**This bill** would shift the burden of proof from taxpayers to the agencies collecting taxes in any court proceeding with respect to factual issues if the taxpayer (1) shows a prima facie justification for the factual or legal contention and (2) fully cooperates with the state agency in disclosing all relevant evidence.

For purposes of **this bill**, state agency includes FTB, the Board of Equalization (BOE), the Employment Development Department (EDD) and any other agency that collects taxes.

**This bill** would not be construed to supersede or limit the application of any legal requirement to substantiate any item.

**This bill** also would declare legislative intent to conform to the Internal Revenue Service Restructuring and Reform Act.

#### Policy Considerations

This bill would raise the following policy considerations.

- Shifting the burden of proof in any court proceeding could impact every assessment made by the department and could result in reduced compliance and more intrusive audits.

The Tax Executives Institute, representing approximately 5,000 corporate tax professionals, indicated in a letter to the Congressional Ways and Means Committee Chair that its organization fears that shifting the burden of proof would result in a much more intrusive IRS.

Because wage earners' and retired individuals' records are supplied to the IRS and FTB by employers and others, shifting the burden of proof to taxing agencies in instances involving these types of taxpayers would be somewhat insignificant. However, businesses dealing primarily with cash transactions, those in the "underground economy," could benefit from a shift in the burden of proof. Such taxpayers may be more likely to take aggressive positions on returns and contest audit results. Audits would have to be more thorough to obtain the proof necessary to sustain audit findings.

- On the other hand, for many taxpayers the income tax system is their only contact with government and the large bureaucracy frightens them. Thus, they may not protest or appeal audit findings even if they believe them incorrect. Proponents believe that this provision would create a better balance between government and taxpayers.

- Generally in civil cases the burden of proof is on the plaintiff, the party seeking corrective action (with the exception of civil fraud). The taxpayer is the plaintiff in all California Superior Court actions. In addition, for tax cases the taxpayer has control of the records and documents necessary to ascertain the taxpayer's tax liability.
- Federal legislation regarding the burden of proof has not been enacted. Generally, state legislation is enacted after federal legislation to allow the state to conform (where applicable) to new federal law. If this bill is enacted and the federal legislation is not the same, taxpayers may be confused by the differences in federal and state law. Thus, state legislation in this area may be premature. Further, this provision is much broader than the proposed federal legislation.
- Currently, the taxpayer is asked to substantiate the amounts reported on the return, and deductions are considered to be a matter of legislative grace. The Internal Revenue Code (IRC) and R&TC have few statutes that specifically require substantiation; the requirement to substantiate an item rests mainly in case law regarding burden of proof.

#### Implementation Considerations

This provision would raise the following implementation considerations. Department staff is available to help the author resolve these concerns.

- The bill is internally inconsistent. Section 1 declares legislative intent to conform to the Internal Revenue Service Restructuring and Reform Act (which includes a burden of proof provision) while the burden of proof provision in Section 2 is inconsistent with the proposed federal legislation. The proposed federal legislation (1) limits the burden of proof shift to the smaller taxpayers, (2) defines what is considered "taxpayer cooperation," and (3) limits the provision to court proceedings arising in connection with "examinations" commencing after the date of enactment.
- The terms "prima facie justification" and "cooperates fully" are not defined. Undefined terms can lead to disputes between taxpayers and the department. Further, the term "evidence relevant thereto" is subjective; taxpayers and FTB may disagree about what is relevant.

If the intent is to pattern California law after the federal provision, it may be better to conform by referencing the federal provision so that federal regulations (which should be provided by the IRS to clarify these terms) are effective for California purposes.

- One significant department workload is assessments based upon federal Revenue Agent Reports (changes made by the IRS to gross income or deductions reported on the federal return). Currently, such adjustments are presumed to be correct. It is unclear whether this provision would remove that presumption and require the department to prove that the changes made by the IRS to the federal return are correct.

- Currently, FTB generally retains taxpayer records for a period of three to four years and then destroys them, as authorized under R&TC Section 19530. Shifting the burden of proof to the department may require longer retention of records and increased costs for storage.
- The potential of a shift in the burden of proof would require FTB to engage in more extensive evidence gathering activities. This may require personnel additions to the audit and legal staff.
- Under certain conditions, this bill would shift the burden of proof to FTB in ascertaining the "tax liability" of a taxpayer. It is unclear whether the burden of proof would be shifted to the FTB on issues related to penalty and interest. In some current statutes, tax includes penalties and interest, and in others it does not. The bill should specify whether "tax liability" includes penalties and interest.

#### Technical Considerations

Amendment 1 would replace "board" with "state agency" to reflect the March 12, 1998, amendments to include all state agencies.

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO SB 1425  
As Amended March 12, 1998

AMENDMENT 1

On page 2, line 20 strikeout "board" and insert:

state agency